

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:NER:MIC:DET:TL-N-2610-00

MELueck

date: JUL 07 2000

to: District Director, Michigan District  
Chief, Examination Division  
Attention: Orlando Mask, Revenue Agent

from: District Counsel, Michigan District, Detroit

subject: [REDACTED], **Golden Parachute Payments**

This memorandum modifies and supplements our Memorandum dated June 15, 2000, wherein we advised you the payments made by taxpayer to [REDACTED] were contingent on a change in control pursuant to I.R.C. § 280G.

**DISCLOSURE STATEMENT**

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the recipient of this document may provide it to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Collection, Appeals or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgement of the office with jurisdiction over the case.

**FACTS**

During [REDACTED], [REDACTED] merged with [REDACTED]. Prior to the merger, [REDACTED], [REDACTED], and [REDACTED] were employees and officers of [REDACTED]. Each officer had an employment agreement with [REDACTED]. Attached as Exhibit A is a copy of the agreement between [REDACTED] and [REDACTED].<sup>1</sup> After the merger, [REDACTED], [REDACTED], and [REDACTED] were either terminated or they voluntarily resigned as employees and officers. [REDACTED] resigned after entering a "Termination Agreement and General Release" with [REDACTED] (hereinafter "termination agreement"). Attached as Exhibit B is the termination agreement between [REDACTED] and [REDACTED].

During the year of the merger and years subsequent to the merger, [REDACTED], [REDACTED], and [REDACTED] received certain payments. The payments were received pursuant to the employment agreements [REDACTED], [REDACTED], and [REDACTED] had with [REDACTED] or pursuant to the termination agreement between [REDACTED] and [REDACTED]. All three employment agreements were entered on [REDACTED] and amended on [REDACTED]. Attached as Exhibit C is a copy of the amendment to [REDACTED]'s employment agreement.<sup>2</sup> The termination agreement between [REDACTED] and [REDACTED] was entered on [REDACTED].

Some payments pursuant to the employment agreements were received before the merger while the remaining payments were received after the merger. All payments received by [REDACTED], pursuant to the termination agreement, were paid subsequent to the merger.

Payments received pursuant to the employment agreements, which were paid subsequent to the merger, were contingent on the

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<sup>1</sup>The agreements [REDACTED] and [REDACTED] had with [REDACTED] are identical to [REDACTED]'s except for the amounts of compensation. The agreements included two pertinent provisions. Paragraph three of these agreements, entitled "Compensation", outlined the compensation each officer was to receive. Paragraph four of the agreements, entitled "Termination of Employment", described the amounts each officer would receive should he resign or his employment be terminated.

<sup>2</sup>The amendments to the employment agreements of [REDACTED] and [REDACTED] are identical to the amendment to [REDACTED]'s employment agreement.

change in ownership or control. This advice pertains to the payments received prior to the merger and the payment received by [REDACTED] pursuant to the termination agreement. The payments were received according to the following schedule:

<u>Officer</u>	<u>Employment</u>		<u>Termination</u>		<u>Total</u>
	<u>Prior to</u>	<u>After</u>	<u>Agreement</u>	<u>Agreement</u>	
	<u>the merger</u>	<u>the merger</u>			
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]			\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]			\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]		\$ [REDACTED]

The officers' base amounts (five-year average annual compensation) and threshold amounts (three times the base amount) are as follows:

<u>Officer</u>	<u>5-year average</u>	<u>Threshold amount</u>
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]

#### ISSUE

1. Whether amounts paid to [REDACTED], [REDACTED], and [REDACTED] during the taxable year of the merger of [REDACTED] and [REDACTED] but prior to the merger, were contingent on an event closely associated with a change in control under I.R.C. § 280G.

2. Whether payments received by [REDACTED] pursuant to the Termination Agreement and General Release were contingent on a change in control under I.R.C. 280G.

### CONCLUSIONS

1. No. The amounts paid to [REDACTED], [REDACTED], and [REDACTED] during the taxable year of the merger, but prior to the merger, would have been made had the merger not occurred. Furthermore, the payments were not contingent on an event that was closely associated with the merger. Therefore, they were not contingent on a change in control.

2. Yes. The termination agreement between [REDACTED] and [REDACTED], with respect to severance pay, was entered pursuant to the Executive Employment Agreement between [REDACTED] and [REDACTED] and the payments were made pursuant to the agreement. Therefore, the payments are presumed to be contingent on the change in control.

### LAW

Internal Revenue Code section 280G defines the term "parachute payment" as any payment in the nature of compensation paid to a disqualified individual if the payment is contingent on a change in the ownership or effective control of the corporation and the aggregate present value of the payments equal or exceed three times the recipient's five-year average annual compensation.

Section 280G(b)(2)(C) provides that any payment pursuant to an agreement entered into, or amended, within one year prior to the change in ownership or control is presumed to be contingent on such change.

Section 1.280G-1, Q&A 22, of the Income Tax Regulations explains that a payment is treated as contingent on a change in ownership or control if the payment would not, in fact, have been made had no change in ownership or control occurred.

Regulation 1.280G-1, Q&A 22(b) explains that a payment is also treated as contingent on a change in ownership or control if: (1) the payment is contingent on an event that is closely associated with a change in control; (2) the change in control actually occurs; and (3) the event is materially related to the change in control. An event will be presumed to be materially related to a change in control if the event occurs within one year of the change.

Regulation 1.280G-1, Q&A 23(a) provides that payments are not treated as contingent on a change in ownership or control if they are made pursuant to an agreement entered into after the change. For this purpose, an agreement entered into after a change in control, pursuant to a legally enforceable agreement

that was entered into prior to the change, will be considered to have been entered into before the change.

### ANALYSIS

A corporation's deduction for reasonable compensation is affected by the classification of the payments made to its employees. If an employee received parachute payments, then, under I.R.C. § 280G, the deduction for compensation must exclude the amount in which the sum of the parachute payments exceed the employee's threshold amount. Thus, if all payments received by [REDACTED], [REDACTED], and [REDACTED] are parachute payments, the taxpayer would only be permitted to deduct, as reasonable compensation, a total of \$[REDACTED], \$[REDACTED], and \$[REDACTED], respectfully.

Under I.R.C. § 280G, [REDACTED], [REDACTED], and [REDACTED] are "disqualified individuals," as that term is defined in I.R.C. § 280G(c). A payment qualifies as a parachute payment if it is contingent on the change in the ownership or effective control of the corporation and the sum of all such payments equals or exceeds three times the individual's five-year average annual compensation (threshold amount). If all payments received by [REDACTED], [REDACTED], and [REDACTED] were contingent on the merger, they will be treated as parachute payments. However, if the payments made prior to the merger are not treated as contingent on the merger, then none of the payments received by [REDACTED] would be parachute payments. Furthermore, if the payments made pursuant to [REDACTED]'s termination agreement are not treated as contingent on the merger, then none of the payments received by [REDACTED] would be parachute payments.

A payment is contingent on the change in effective control if it would not have been made had there not been a change in control. In this case, a change in control, through the merger, occurred in [REDACTED]. There is no question that the payments made subsequent to the merger, which were pursuant to the termination clauses in the employment agreements, were contingent on the change in control. A question remains, however, whether the payments made prior to the merger and whether the payments made to [REDACTED], which were pursuant to the termination agreement, should be treated as contingent on the change in control.

#### ISSUE 1:

A payment made prior to a change in ownership or control will be treated as contingent on the change in ownership or control if: (1) it is contingent on an event that is closely associated with the change in ownership or control; or (2) the

payment is made pursuant to an agreement that is entered or amended within one year prior to the change.

Under regulation 1.280G-1, Q&A 22, a payment is treated as contingent on an event that is closely associated with a change in ownership or control unless it is substantially certain, at the time of the event, that the payment would have been made whether or not the event occurred. Regulation 1.280G-1, Q&A 22(b), provides a nonexclusive list of events that are considered closely associated with a change in control. Furthermore, an event is presumed to be closely associated with a change in ownership or control if it occurs within one year of the change. Although these payments were not contingent on an event described in regulation 1.280G-1, Q&A 22(b), the payments were made within one year of the merger. The facts, however, indicate that these payments were made pursuant to the employment agreements [REDACTED], [REDACTED], and [REDACTED] had with [REDACTED], not an independent event. These payments would have been made even if the merger between [REDACTED] and [REDACTED] never occurred. Therefore, the payments were not contingent on an event that is closely associated with the change in control.

Although a payment would have been made whether or not a change in control occurred, the payment, if made pursuant to an agreement, may still be treated as contingent on a change in control under certain circumstances. Under I.R.C. § 280G(b)(2)(C), a payment made pursuant to an agreement entered into, or amended, within one year prior to the change in ownership or control is presumed to be contingent on the change. [REDACTED], [REDACTED], and [REDACTED] entered their respective employment agreements on [REDACTED], more than one year prior to the merger. These agreements were amended on [REDACTED], less than six months prior to the merger. Regulation 1.280G-1, Q&A 25, provides, that in the case of an amendment to the agreement, only the portion of any payment that exceeds the amount that would have been made in the absence of the amendment is presumed to be contingent on the change.

The amendments did not affect the termination clauses in the agreements, therefore, no amount of the payments exceeded what would have been made in the absence of the amendments. Thus, no amount of the payments are presumed to be contingent on a change in control.

The fact that there is no presumption, however, does not imply that the payments could not have been contingent on the change. Whether payments were contingent on a change in ownership or control is a factual determination. This determination must be made with due regard to all the facts and

circumstances surrounding the payments, i.e., whether the amounts of the payments were consistent with previous practice, whether the payments were made in contemplation of the change, etc. There are no facts which indicate that these payments were not made in accordance with [REDACTED]'s previous practice. Furthermore, although there is some evidence that negotiations between [REDACTED] and [REDACTED] may have occurred prior to the payments, this evidence standing alone does not support a finding that the payments were contingent on the merger. Therefore, the payments made prior to the merger should not be considered in determining whether [REDACTED] made excess parachute payments to [REDACTED], [REDACTED], and [REDACTED].

## ISSUE 2:

As recognized above, under I.R.C. § 280G(b)(2)(C), a payment made pursuant to an agreement entered into, or amended, within one year prior to the change in ownership or control is presumed to be contingent on the change. [REDACTED] entered his termination agreement with [REDACTED] on [REDACTED], less than two months following the merger. Although this agreement was entered after the change in ownership or control, regulation 1.280G-1, Q&A 23, provides that payments made pursuant to an agreement entered after a change in control are treated as contingent on the change if the agreement entered after the change in ownership or control was entered pursuant to a legally enforceable agreement that was entered prior to the change.

With respect to [REDACTED]'s severance pay, the termination agreement between [REDACTED] and [REDACTED] required [REDACTED] to receive severance pay in accordance with the previously entered Executive Employment Agreement. Thus, as it relates to [REDACTED]'s severance pay, the termination agreement was entered pursuant to the Executive Employment Agreement [REDACTED] had entered in [REDACTED]. Without facts indicating the contrary, this advice assumes the Executive Employment Agreement was legally enforceable. Therefore, although [REDACTED] entered the termination agreement after the change in control, the termination agreement, as it relates to [REDACTED]'s severance pay, will be considered as entered prior to the change because it was entered pursuant to a legally enforceable agreement entered prior to the change in ownership or control. Therefore, the payments received by [REDACTED] are presumed to be contingent on the change in ownership or control.

Furthermore, under regulation 1.280G-1, Q&A 22(b)(1), a payment is treated as contingent on a change in ownership or control if it is contingent on an event closely associated with a change in ownership or control, the change actually occurs, and

the event is materially related to the change. Example 1 in regulation 1.280G-1, Q&A 22(e) provides that "termination of employment is considered closely associated with a change in ownership or control." Also, under regulation 1.280G-1, Q&A 22(b), an event is presumed to be materially related to a change in ownership or control if the event occurs within one year of the change. In this case, [REDACTED] was terminated less than one year after the change in ownership or control and his severance pay was contingent on his termination, therefore, the payment [REDACTED] received pursuant to the termination agreement will be treated as contingent on the change in ownership or control and must be included in the determination of whether [REDACTED] received a parachute payment.

If you have any questions or comments regarding this memorandum or the subject matter addressed, please do not hesitate to contact Michael E. Lueck at (313) 237-6437.

PHOEBE L. NEARING  
District Counsel

By: 151

MICHAEL E. LUECK  
Attorney

Attachments:  
As stated.